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Swiss Federal Supreme Court Confirms the Principles for the Admissibility of a Success Fee

Georg von Segesser (von Segesser Law Offices) and Petra Rihar (Lanter) · Sunday, October 7th, 2018

In a decision dated 26 July 2018 and published on 29 August 2018, the Swiss Federal Supreme Court (the "Supreme Court") dismissed an appeal to set aside an arbitral award as it found that Swiss public policy was not violated by a sole arbitrator's confirmation of a success fee owed to a Swiss law firm by its client. With reference to its previous case law, the Supreme Court held that the disputed success fee did not raise any issues despite the disproportion between its fixed and variable parts and the lack of alignment it created between the client's and counsel's interests (4A_125/2018).

Background

B. AG, a Zurich based law firm ("B"), and A. SA, a Portuguese company seated in Oliveira de Frades ("A"), entered into two Engagement Letters agreeing that B would represent A, as claimant and counter-respondent, in two ICC arbitration proceedings: the first against C GmbH and the second against D GmbH. With respect to B's remuneration, B and A agreed on a combination of a reduced hourly fee and a success fee. The Engagement Letters were subject to Swiss law and contained an arbitration clause in favour of Swiss Rules arbitration in Zurich.

The Engagement Letter concerning the ICC arbitration against D GmbH provided for different remuneration scenarios in case that the amount sought by A would be determined by a decision or a settlement:

> "A success fee consisting of 15% on (i) any amount claimed by and awarded to A. SA (ignoring any successful set-off defence) applies.
> The success fee becomes payable in addition to the reduced blended hourly rate. The amounts in question do not include any compensation for attorney's fees or other costs of arbitration and apply irrespective of whether the amount is determined by a decision of [sic] settlement.
> In the event of a full settlement disposing of all claims in the arbitration, the success fee is reduced to 4% calculated based on the difference between the aggregate amount in dispute (total of claim, counter-claim and sett-off defence).
> Should B. AG consider a settlement offer made by D. GmbH to be appropriate, it may request A. SA to consent to such offer. Should A. SA not wish to agree to the settlement offer, B. AG in its own discretion may opt to be compensated in line with

> this success fee arrangement as if the settlement offer had been accepted.
> In no event may (i) the success fee be negative or (ii) exceed CHF 1'500'000 or its equivalent in other currencies (success fee cap)."

The amounts in dispute for the two proceedings were EUR 10.2M for A.'s claim and EUR 147.2M for the counterclaim in the dispute with C., respectively EUR 3.1M for A's claim and EUR 1.8M for the counterclaim in the dispute with D.

After A had reached a settlement with respect to both ICC arbitrations for a total amount of EUR 11.5M to be paid by A, B invoiced A for unpaid hourly fees in the amount of CHF 168,633.60 and the payment of a success fee in the amount of CHF 2M, reduced at B's discretion from CHF 2.5M (i.e. the sum of the fee caps for the two disputes). A contested the invoice.

B initiated arbitration proceedings against A in Zurich seeking the payment of CHF 2.5M plus interest and expenses. The sole arbitrator ordered A to pay B fees in the amount of CHF 1,666,722, plus interest. When analyzing the admissibility of the disputed success fee, the sole arbitrator considered the principles set out by the Swiss Federal Supreme Court in its decision 4A_240/2016 dated 13 June 2017 (BGE 143 III 600). Regarding the permissible amount of the success fee however, the sole arbitrator expressly deviated from said Supreme Court decision.

A appealed before the Supreme Court arguing that the decision of the sole arbitrator violated Swiss public policy (article 190(2)(e) of the Private International Law Act, "PILA") because his interpretation of the Engagement Letters disregarded the principle of a lawyer's duty of independence due to both the amount of the contingency fee and the fee arrangement's different outcomes for resolving the dispute by decision or settlement.

Decision

The Supreme Court begins its considerations with an analysis of the contested fee agreement. It notes in particular that the agreed upon difference in the calculation of the success fee in case of settlement rather than an arbitral award, resulted in an incentive for counsel to get A to settle the dispute. Indeed, the success fee cap amount of CHF 1.5M could only be reached if 97% of the appellant's claims were granted by an award. By contrast, in case of a settlement, the reduction of the counterclaims by a mere quarter would suffice to reach the cap. The Supreme Court also refers to the sole arbitrator's determination that the success fee cap amount would be owed in most cases where the parties reached a settlement. Moreover, the Supreme Court notes that the option granted in the third paragraph of the success fee clause effectively guarantees counsel the settlement-based success fee even if the client were to reject the settlement offer.

Noting that a success fee arrangement can only lead to a better representation of a client if it keeps the interests of client and counsel aligned, the Supreme Court finds that the necessary incentive for counsel was absent from the present fee arrangement. Under these circumstances, the acceptance of a settlement may have been an appropriate solution for the client, but not necessarily also the most economically beneficial.

The Supreme Court goes on to state that an arrangement such as the one under review, where the success-based fee amount outweighs the fixed (hourly) amount by a factor of five, is especially problematic with regard to the independence of counsel as well as certain other provisions of the domestic Swiss law governing the legal profession ("BGFA"). However, in light of its restricted

scope of review in appeals against arbitral awards pursuant to art. 190 (2) PILA, the Supreme Court deems these issues not decisive for the present appeal.

Delving into its examination of the alleged violation of Swiss public policy ("ordre public"), the Supreme Court restates its longstanding practice in the matter as follows: the substantive determination of a disputed claim only violates public policy if it fails to recognise fundamental legal principles and, as a result, becomes wholly incompatible with the essential, largely recognised system of values, which, according to the prevailing view in Switzerland, should form the basis of every legal system. These principles include pacta sunt servanda, the prohibition of abuse of rights, the principle of good faith, the prohibition of expropriation without compensation, the prohibition of discrimination, the protection of vulnerable persons and the prohibition of excessive commitment (cf. Art. 27 para. 2 CC) if this constitutes an obvious and serious violation of personality.

The Supreme Court then classifies the present dispute as an issue of the conflict between counsel's pecuniary interests and those of the client, rather than an issue of the lawyer's independence from the client's counterparty. It is in this context, that the Supreme Court goes on to review the following precedents regarding the question whether lawyers' success fees are compatible with the Swiss public policy.

In an enforcement decision, an award granting a success fee of USD 1,837,500 (corresponding to approximately 2% of the total settlement amount) was classified as compatible with Swiss public policy (5A_409/2014). In another decision, the Swiss Federal Supreme Court held that a foreign arbitral award granting a success fee amounting to 30% of the procedural profit did not violate Swiss public policy (5P.201/1994). Even with a success fee of more than CHF 6,500,000, corresponding to approximately 6.5% of the financial interest, a violation of Swiss public policy was denied, even though the fee agreement in question was a pactum de quota litis, which would be inadmissible under domestic Swiss law (5P.128/2005).

Against this background, the Swiss Federal Supreme Court finds that the success fee under the first engagement letter does not raise any issues. With regard to the second engagement letter, it notes that the total amount of fees confirmed by the sole arbitrator amounts to less than 2% of the amount in dispute, which cannot be considered a violation of Swiss public policy. As for the disproportion between the fixed ("Fixhonorar") and variable parts ("Erfolgshonorar") of the fee and the lack of aligned interests resulting from the increased fee in case of a settlement, the Supreme Court finds that these elements also fail to amount to a violation of public policy. Consequently, the Supreme Court dismissed A's appeal.

Comment

In the present decision, the Supreme Court confirms that a success fee ("*pactum de palmario*") is in principle admissible under Swiss law. However, due to the international nature of the arbitral award under appeal and its correspondingly restricted scope of review with regard to alleged violations of Swiss public policy pursuant to art. 190 (2) of the PILA, it does not examine the admissibility parameters under domestic Swiss law as set out in BGE 143 III 600. Instead, it validates the sole arbitrator's explicit departure from those domestic requirements and refers to its established jurisprudence on the compatibility of success fees with Swiss public policy to validate the award. In doing so, it indicates that only the nominal amount of fees or the ratio between the total fees and the amount in dispute are relevant with regard to an alleged violation of public

policy; not however any detrimental effect on lawyerly independence or conflicts of interest created by such a fee arrangement.

For reference, under Swiss law, a lawyer's success fee is admissible only under the following conditions:

(1) Regardless of the outcome of the proceedings, the lawyer must earn an hourly fee which not only covers his own costs, but also enables him to make a reasonable profit.

(2) There must be a reasonable ratio between the performance-related component and the hourly fee which is owed regardless of the outcome of the case to ensure that lawyer's independence is not impaired and there is no risk of unfair advantage.

(3) The Supreme Court further sets a time limit: The remuneration agreement containing a success fee, may be concluded at the beginning of the mandate or after the end of the legal dispute, but not during the ongoing representation in a dispute.

(4) The Supreme Court also states that success fees must be scrutinized against the background of Art. 12 lit. e and lit. i of the BGFA warranting the lawyer's independence as well as the maintaining of clear conditions with regard to the invoicing.

One question that the Supreme Court's decision does not address is whether a fee agreement such as the present one could lead to the sanctioning of counsel by the supervisory body for violation of professional conduct rules.

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